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From the trenches

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Wilful ignorance: the struggle to convince the free trade skeptics[1]

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Good evening. I am delighted to be back here this evening among so many old friends.

As you know, I addressed the WTO General Council this morning, partly to underline the IMF's support for the negotiations that we hope will lead to a successful conclusion of the Doha Round; and partly to explain the new initiative – the Trade Integration Mechanism – that the Fund has developed in order to remove one possible obstacle to success.

I thought that for this evening, I should choose a provocative, perhaps even mischievous, title for my talk. I do have a serious purpose. But it is not to dismiss out of hand the arguments of those who doubt the benefits of free trade.

Instead, what I want to do tonight is examine why opposition to trade liberalization remains so strong in some quarters, despite the theoretical and empirical evidence indicating that growth, rising living standards and poverty reduction all proceed more rapidly in countries with more liberalized trade regimes. And I want to explore briefly what more we in the policy arena might do to win over the skeptics.

I should say at the outset that to win hearts and minds we need to listen. We should welcome engagement with those who prefer protectionism to liberalization. We should seek to understand the basis of their arguments. And we should

1 Address to the Graduate Institute of International Studies, Geneva, May 18, 2004.

seek to persuade them, not just by reason, though that is always a good start, of course; but by marshaling the evidence.

Who are the skeptics?

Protectionist pressures have always been with us. Opposition to free trade has been a constant in debates running back more than two centuries. The modern anti-globalization movement was galvanized by the protests at the WTO Ministerial meeting in Seattle in 1999. The protesters are pre-occupied with a range of concerns, including the environment, political accountability, big business, and so on. But the opposition to free trade is a constant and recurring theme of most of the anti-globalization protesters.

These protesters, and the opponents of free trade in general, are a disparate group. They often seem united only by what they are against – not what they are for. Those of us who believe – indeed, I would say know – that free trade makes possible rapid sustainable growth, rising living standards and poverty reduction must recognize that our debate is with, at best, a loose coalition of overlapping interests.

But I am not, tonight, directing my remarks solely at the anti-globalization protesters. A surprising number of governments, especially in the developing world, remain fundamentally skeptical of the potential benefits of free trade. Poor countries are those who stand to gain most from a successful conclusion to the Doha round: the World Bank estimates that around two thirds of the benefits would accrue to developing countries. Yet policymakers in many of these countries remain at best skeptical, at worst philosophically opposed, to the idea of trade liberalization as something to which developing as well as industrial country governments should be committed.

Looking around tonight, I think that this is one of those rare occasions when those of us who are convinced of the benefits of free trade are in a majority. We clearly have much work to do, to convince the doubters that we have both theoretical and empirical evidence on our side.

It was ever thus, of course. It is telling to look back at the debate over the British Corn Laws between 1815, when the Corn Law was first introduced, and 1846, when the law was finally repealed (158 years ago this week, incidentally). Those in favor of government protection for agriculture included the landowners, anxious to protect their rental income and their land values. It also included the working classes, organized as the Chartist Movement, who were encouraged to fear that cheaper corn would mean lower real wages.

In fact, the debate over the Corn Laws is a powerful reminder of how little has fundamentally has changed in the way the debate over free trade is conducted. Let me quote from Charles Villiers, a Member of Parliament for the Midlands who was a fervent opponent of the Corn Laws, and who introduced a motion in the House of Commons every year until 1846 calling for their repeal. In

1838, Mr Villiers neatly summarized the foundations for his commitment to free trade:

> For what is this freedom but liberty for persons to provide, and the community to enjoy, that which is needful and desired at the lowest cost and at the greatest advantage.

What drives opposition?

It is clear from reading the arguments at the time that two principal motives inspired the opponents of free trade. One was fear; the other a desire to protect vested interests. These motives have persisted into the twenty-first century.

In nineteenth-century Britain, fear of free trade took several forms. There was the fear for one's livelihood: I have already mentioned the Chartists who sought to protect the working classes from the illusory threat of falling real wages. There was also fear linked to national security: could Britain afford to increase its reliance on food imports if corn prices fell and foreign competition increased? And there was fear about the ability of the Exchequer to cope with lower customs revenues – still nearly 40 % of all government revenues in 1846.

It is striking how these arguments continue to resonate in today's debate. Labor movements continue to fear foreign competition that they believe will drive them out of jobs, or lower their living standards. Agricultural producers around the world still exploit the argument that food is somehow different from other commodities: that not being self-sufficient in food might undermine national security. And many developing country policymakers are anxious about the impact on government revenues of further trade liberalization.

Now, as in nineteenth-century Britain, those with vested interests at stake are quick to exploit the fears of others. Then it was agricultural landowners who benefited greatly from high corn prices. They were largely protected by foreign competition – no imports were permitted unless corn reached a price of 80 shillings. This ensured that both their rental income and the value of their land were protected.

It is true that the vested interests at stake in the contemporary debate about trade liberalization are rather more diverse. They certainly include the agricultural sector in developed countries – and in many developing countries. But the interest groups clamoring for protection, or already enjoying it, include manufacturers, sections of organized labor, and, increasingly in developed countries, parts of the services sector.

One group is missing, both in nineteenth-century Britain and across the globe today – consumers. The British free traders recognized this. Speaking in Parliament in 1843, Richard Cobden confronted the impact of high corn prices on the poor: the ten counties with the highest recorded number of paupers were, he noted, all exclusively agricultural. High corn prices had not benefited workers or the community.

Similarly today we hear much talk of protecting jobs, but little attention is paid to the higher prices for consumers that result from tariff and non-tariff trade barriers. Yet the impact of higher prices on an economy could far outweigh the benefits to a small group of workers or industrialists. Losses incurred by a small minority can be compensated through social safety nets at much lower cost to society as a whole. Listen once more to our friend Mr Villiers who said in that same Parliamentary debate in 1838 that:

> the community are called on to forego an advantage which is at hand, in order to continue for ever a comparatively few persons in a particular employment.

The paradox Charles Villiers describes goes right to the heart of the free trade debate.

The harm that protection inflicts on consumers is, nowadays, widely discussed and understood among those who argue in favor of free, and freer, trade. I do not want to downplay this aspect. But this evening I want to go further, and argue that the impact of protectionism on other producers, and on the macroeconomy as a whole, is far greater than has been generally recognized. For reasons I will come to in a moment, these costs are difficult to measure or estimate; and this is an important factor in their being overlooked. The ability of special interests to manipulate political decision-making processes has compounded the problems and, in my view, serves to highlight both the need for institutional change at the national level and the importance of a multilateral approach to free trade.

The benefits of free trade

As everyone in this audience knows, the benefits of free trade are clear. The evidence to support the argument for trade liberalization is powerful. And there is much more tangible evidence now than there was when the nineteenth-century free traders launched their campaign. Richard Cobden talked about free trade being theoretically right, and right in the abstract; he urged his fellow parliamentarians to apply this truth.

But we also have the advantage of twentieth-century experience and, in particular, the rapid growth of the world economy after 1945, which was largely driven by the much more rapid expansion of world trade. And the growth of world trade in the postwar period was not accidental but by design. The founders of the postwar international economic order understood the lessons of the 1930s, and the beggar-thy-neighbor protectionism that had stifled growth. They were determined that a period marked by the failure of international economic cooperation should not be repeated.

Hence the creation of a multilateral trade framework, first under the auspices of the General Agreement on Tariffs and Trade (GATT) and then its successor, the WTO. This framework envisaged progressive multilateral trade liberalization.

Tariff and non-tariff barriers were lowered in successive trade rounds; the most favored nation principle was a central feature of the liberalization process.

And the institutions established by the Bretton Woods conference were explicitly intended to reinforce this process. Article 1 of the International Monetary Fund's Articles of Agreement could hardly be clearer: the Fund's purpose is to:

> facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income … as primary objectives of economic policy.

And it worked. In 1950, merchandise exports accounted for about 8% of world GDP; by 2002 that figure had risen to 19%. It is difficult *ex post* to realize quite how ambitious were the aims of the architects of the postwar economy. We have not seen at first hand the damage wrought by aggressive protectionism on a global scale. We *can* see that trade liberalization brought huge benefits. It paved the way for the most rapid and sustained economic expansion in history. Almost all countries benefited, rich and poor.

The latest *Economic Report of the President*, issued in Washington earlier this year, cites a study by Warcziarg and Welch of 133 countries between 1950 and 1988. Countries that liberalized their trade regimes enjoyed annual growth rates about one half of one percentage point higher after liberalization. And opening up to international trade has become increasingly important: removal of trade barriers during the 1990s raised growth rates by two point five percentage points a year.

The postwar rise in living standards – across the globe – is obvious on a wide range of measures: literacy rates, infant mortality, poverty rates, and life expectancy have all shown widespread improvements. And, although the industrial countries benefited first, the growth rates they enjoyed in the 1950s soon paled by the achievements of some of the newly industrializing countries of the 1960s and 1970s.

For me, the single figure that brings home quite how much was achieved in that postwar era is the gap between life expectancy in rich countries and that in poor countries. In 1950 that gap was 30 years. It is around ten years today – because life expectancy in most poor countries has risen even more than it has in rich countries.

Such sustained and rapid growth rates, and the rising living standards and falling poverty that result, would not have been possible without progressive trade liberalization. Of course, it is possible for closed economies to achieve high growth spurts. But no country has succeeded in rapid growth over a sustained period without opening its economy to the rest of the world.

A puzzle?

So we are left with two questions. Why, given its proven track record, is trade liberalization something governments around the world seem so reluctant to embrace? And why are the opponents of free trade in society as a whole so much more vocal than its advocates?

One explanation for government behavior is that many of them have been captured by special interest groups – just as the British government was in the early part of the nineteenth century. There is clearly something in this. Modern-day agricultural protection is a classic example, of course. I am told that it is risky to drive from Geneva to shop in France because on the way back your car might be searched to ensure you have not exceeded the modest food allowances. Now that might be ascribed to a form of consumer protection, I suppose, in case you catch anything from the French food; but something tells me it owes far more to state protection for Swiss farmers and is therefore not in the interests of Swiss consumers.

Agricultural protection in rich industrial countries is, simply, indefensible. Its sheer scale is shocking. And, if you think I exaggerate, let me tell you about the cows.

The annual cost to consumers and taxpayers of 29 OECD members' support for agriculture and horticulture is so large that it could pay for each of the 56 million cows in the OECD dairy herd to enjoy a first class air ticket around the world. Each cow would also have $1450 spending money to finance stopovers in the US, Europe and Asia. If the cows were willing to slum it in business class, they could have $2800 spending money instead. And they could enjoy this luxury holiday every year.

This is amusing, of course, but it is also alarming. And countless similar examples abound. It has been estimated, for example, that *each one* of the 2,300 jobs saved in the American sugar industry through barriers to imports in the 1990s cost around $800,000 per year. Similar results would come from calculating the impact of European Union or Japanese – or Swiss – trade barriers. Or take the 216 jobs saved by protection for the US benzenoid chemical industry – almost $1.4 million per year per job.

Such industrial country protection should be ended. It imposes enormous costs on consumers and taxpayers in the rich countries. And it deprives poor farmers in poor countries of access to open markets where they might have a comparative advantage.

But agricultural protection is hardly rare in developing countries either. I could cite plenty of examples of state protection for small groups of producers in developing countries that benefit no one but those producers. Such protection penalizes consumers – and penalizes poor consumers disproportionately because they spend more of their incomes on food.

Developing country protection often harms producers in other developing countries. Developing country tariff barriers have long been higher against each other than industrial country barriers have been against the developing world. One recent study suggests that barriers in other developing countries might account for up to 70% of the total tariffs levied on developing countries' industrial exports.

Agriculture is only one example of the way an interest group exploits its political advantage. Manufacturers have also become expert at pressing their own narrow self-interest against the wider welfare considerations that governments should take account of. And more recently we have seen signs, in the US and other industrial economies, of lobbying against outsourcing – even though Fund research suggests that the US is a net beneficiary of such trade flows, and, indeed, that the US is a net exporter of outsourcing services.

Some explanations

Why are protectionists so successful?

I think one important factor is that proper assessments of the costs and benefits of protection are absent from the debate. A sound analysis would examine whether protection would deliver the results its advocates claimed. Now it may be true that such calculations are difficult to do *ex ante*. But there is a growing body of evidence available which enables us to test whether, in any given circumstance, protection is likely to achieve the results sought by those clamoring for it.

Almost all of this evidence suggests that protection does not achieve its aims. A large research project that I conducted under the auspices of the National Bureau of Economic Research just over a decade ago was pretty conclusive. In the US auto industry, for example, protection, mainly through the use of Voluntary Export Restraints, simply postponed the restructuring of the industry. Only when the automakers were subject to tough competition were they forced to become more efficient and productive. This resulted in thousands of jobs lost – the jobs the protection had been intended to save. And in the interim, protection delivered higher profits to the mainly Japanese car producers whose exports to the US were limited under the VERs.

It is a similar story in Britain and elsewhere in Europe for cars; and for most industrial countries who over the years tried to protect a range of industries from foreign competition. Britain lost its domestically owned car industry (though it became an efficient car producer as a result of foreign ownership and international competition). The manufacturers of European video recorders were not helped by a French ruling that all such electronic products made in Japan had to be imported via Poitiers – though Japanese producers once again enjoyed higher profits for a while.

Or take textiles. The textile industry in most industrial countries has enjoyed protection of one form or another since the 1950s. Has it halted the decline of the textile industry in these countries? Hardly.

Proper assessments of the benefits are missing: so too are judgments about the likely costs. Yet the costs imposed by protection are, as Mr. Villiers noted, substantial. Protecting the output of an industry raises the price paid by the consumer – whether at the retail level, or by other industries. Such costs are in almost all cases likely to be significantly higher than the putative benefits of protection. Protection also deprives consumers of variety.

As I mentioned earlier, though, there are also costs to other producers. In the first place, protection for one industry, by raising the price of that industry's output, will raise the costs of producers that consume that good as part of their production process. Higher steel prices affect automakers, and producers of domestic appliances; higher textile prices raise the cost of clothing production.

But protection imposes another set of costs on producers, specifically those geared to export production. By raising the cost of some (protected) intermediate products, it enables other countries to compete more effectively and so disadvantages exporters in the country providing protection for one or more of its import-competing industries.

So pressure for protection is usually misguided, because it ignores the balance of costs and benefits involved. It also deprives citizens of the opportunity to make informed choices. It might, for example, be the view of society that industry X should, for one reason or another be given support. But that judgment should be based on a complete understanding of the costs. And direct financial aid would in any case be less expensive than protection.

In spite of the many objections, though, protectionists enjoy remarkable success around the world. One important factor that helps them is what we might call identity bias. Thomas Schelling has written about this in the context of societal estimates of the value of life. But his argument is valid in the context of trade protection too.

Put simply, those who fear for their jobs, or their firms, know who they are. It can be easier to focus energy on fighting a specific threat than it can be to defend a tangible but less easily defined public good. Thus a manufacturer, or a farmer, or a worker whose own livelihood might be threatened will be more strongly motivated to defend himself than either a consumer, who might have only a vague idea of how much extra he will have to spend on this good or that, or even a worker who might otherwise find more highly paid employment in an export industry that would expand in the absence of trade-distorting policies.

And identity bias means that those seeking help can mount a strong case because society can more easily identify with, say, a small town in the Southern United States losing a textile factory or the employees of an Italian car-maker facing redundancy than with the as yet unknown companies whose employment would otherwise expand by more, or contract by less.

This problem of identification becomes even more complicated when we try to assess who might actually lose because of jobs not created in exporting industries: protection of some industries is taxation of others. Those who stand to gain from freer trade are less easily identifiable: but the overall economic gain far outweighs the benefits to the limited group enjoying protection.

So we can begin to see why the opponents of free trade have such a built-in advantage. They are also helped by being able to employ any number of arguments that sound plausible: such as environmental harm or necessity for national defense. A simple message is clearly most effective in a political context. And lobbyists have shown themselves adept at marshaling the most appealing arguments in support of their case, whether or not these are the most candid assessment of their position.

Lobbyists who work so hard to persuade governments – and society – of their viewpoint use the public arena to argue their case as well as private, more direct lobbying tactics. And just like the rich landowners who formed an unlikely alliance with poor workers in nineteenth-century Britain, modern-day lobbyists know how to prey on people's fears and sympathies – and do so with great skill.

Thus we hear much about the need to protect the environment, to act in solidarity with workers in the third world, and to campaign against child labor. But these are often arguments of convenience, concealing the primary motive of jobs, or firm, protection.

Such tactics exploit those with good intentions. Many of those at the vanguard of the anti-globalization movement clearly have the best interests of the world's poor at heart. They want to see living standards raised and poverty reduced, there can be no doubt about that.

But they have been distracted by those whose real motives are narrower and more self-interested. They are bombarded with misleading statistics that present a biased case, often by the omission of key facts.

And they are let down by decision-making processes that give disproportionate weight to special interest groups. Few policymakers fully embrace the free trade rhetoric they espouse. Who can wonder why trade liberalization is regarded with suspicion when so many governments reinforce that suspicion by their own behavior?

The role of government

The policy-making process at national level has, or ought to have, a crucial role in the promotion of free trade, and the resistance of protectionist pressures. One of the most puzzling aspects of the debate on free trade is why trade is singled out as an agent of change that has to be fought against. Many more jobs are lost through technological change, for instance. Many of these job losses are hidden, in the sense that it is easier for an industrialist to argue that this or that factory has been closed, or its workforce reduced, because of the pressure of international trade – or 'unfair foreign competition' – rather than acknowledge that the change was in response to technological advances, poor management, or other factors.

Too often, the institutional framework is geared to trade issues. Changes to this framework can bring genuine improvements in trade policy at the national level. Look, for example, at the Australian Tariff Commission, whose original focus was clear from its title. Yet it went through several guises – the Industries Assistance Commission, the Industry Commission – until it became what is today, the Productivity Commission, with a focus on much broader effects of any measure on the entire economy.

The difficulties that policymakers can face at national level, because of the influence of special interest groups, serves to reinforce the case for multilateral trade liberalization: acting multilaterally makes the jobs of governments easier – in part because export-competing industries can form international alliances to lobby more effectively for trade liberalization. Multilateral action also brings higher returns at a lower cost than unilateral liberalization can.

So I am encouraged by the recent signs that substantive progress is being made. It is clearly important both that the Doha round succeed, and it is important that the current momentum be maintained if a successful outcome is to remain within reach.

I spoke earlier about the costs and benefits in the context of individual cases of protection. The stakes in the Doha round are infinitely greater. There is a wide range of studies suggesting that the addition to global income will be anywhere from several hundred billion dollars to around one trillion dollars. Benefits on this scale accord with our experience of trade liberalization since the Second World War. The World Bank calculates that two thirds of the benefits of a successful Doha round would accrue to developing countries themselves. And most of that would come from lowering their trade barriers against each other.

The role of the Fund

Trade liberalization can be a critical factor in delivering the macroeconomic stability that the IMF seeks to helps it members to achieve. We consistently urge governments to liberalize unilaterally in their own self interest. The benefits of unilateral liberalization overwhelmingly accrue to the country doing the liberalizing.

Of course, as I said, multilateral liberalization is both easier for governments and brings even greater benefits; and the IMF has unequivocally and enthusiastically supported the Doha round. The promotion of free trade is one of our duties, as enshrined in our founding Articles of Agreement. We recognize that policymakers in some developing countries are fearful about the possible impact of further multilateral trade liberalization. We think that in the vast majority of cases, such fears are misguided. Only in a very small number of instances will there be temporary balance of payments costs, and, even then, some of these costs will be offset by the broader benefits of a Doha round settlement.

But in order to assuage the fears of those who might be adversely affected in the short term, the Fund has launched a new initiative, the Trade Integration Mechanism, or TIM. Countries facing balance of payments difficulties as a result of multilateral trade liberalization will be able to seek assistance through the TIM, whether or not they are currently receiving financial assistance through a Fund-supported program.

When we first started to develop this new mechanism, we viewed it rather like an insurance policy. The clear evidence is that only a very small number of countries will ever find themselves needing the assistance that the TIM offers. But if its existence helps provide policymakers in those countries with the assurance they need, it should make it much easier for them to embrace the Doha Development Agenda, knowing that they will be able to exploit the opportunities that an agreement will provide, while worrying less about the potential downside risks, however small these might be.

Conclusion

Free trade is a win–win situation. Everybody can gain, and the gains are large enough to enable compensation to be provided to the losers. Compare that with protection, where the losses are significant and substantial – and the benefits are modest and often illusory or short-term. I have set out some of the factors that I believe have enabled the opponents of free trade to win the argument far more often than is justified by the evidence. More empirical research on the effects of protection can help. So, too, can institutional change that strengthens the inputs of consumers and industrial users of goods for which protection is sought.

Those of us who believe that free trade is in the interest of all people – rich and poor – and all countries – developed and developing – therefore face an enormous challenge. We must seek to persuade the skeptics of the benefits of free trade. We must persuade all governments to narrow the gap between rhetoric and practice.

A successful Doha round outcome would, in my view, be the best possible means of achieving these objectives. It would reduce the risk of a slide back to the beggar-my-neighbor protectionism of the 1930s. It will make possible a new era of rapid economic growth, rising living standards and falling poverty. And it would offer the best possible chance of turning the Millennium Development Goals into achievements rather than targets.

Thank you.